
**Qualified Tuition Programs/
IRC Section 529 Plans****Inheritance
tax notice
#03-09**

The Department of Revenue has received numerous inquiries from taxpayers and tax professionals regarding the tax consequences of investing in Qualified Tuition Programs, also known as Section 529 Plans. This notice provides answers to the most frequently asked questions.

**QUALIFIED TUITION PROGRAMS
/ IRC SECTION 529 PLANS**

A qualified tuition program (QTP) is a program established under the Internal Revenue Code to allow an individual to either prepay a student's tuition or save money in a tax-free account for the educational expenses of a designated beneficiary. In 1996, Tennessee established a QTP named the Baccalaureate Education System Trust (BEST) program. Tenn. Code Ann. Section 49-7-822 specifically exempts the BEST program from any state, county or municipal tax. Therefore, contributions to the BEST program are not taxable for Tennessee gift tax purposes, nor are the earnings of the program taxable for Tennessee income tax purposes.

Most states and some educational institutions have established Section 529 Plans. An investment in a Section 529 plan other than the Tennessee BEST plan will affect a Tennessee resident's tax liability in income tax, gift tax and inheritance tax. Below is an explanation as to how this investment will affect your tax liability.

INCOME TAX

Tennessee taxes interest on notes and bonds and dividends on stock. Income earned on **non-Tennessee** 529 savings plans is subject to the Tennessee income tax if it is interest on notes and bonds or dividends on stock. The majority of Section 529 savings plans are invested in mutual funds. Distributions from mutual funds are "dividends on stock" and, therefore, taxable under the Tennessee income tax. Please refer to the instructions included with the return for additional information on this tax.

GIFT TAX

Section 529 savings plans allow the owner to retain control over the assets until they are distributed. This is a revocable transfer. Under Tennessee gift tax law, revocable transfers are not considered a completed gift and, therefore, no taxable event has occurred when a contribution is made to the savings plan.

Distributions from **non-Tennessee** 529 Plans may be subject to the gift tax. A distribution for payment of tuition is an exempt gift. A distribution for any other purpose is a taxable gift. Therefore, other than tuition payment, total annual distributions over \$11,000 to, or for the benefit of, one donee would result in a gift tax liability to the donor for **non-Tennessee** 529 savings plans.

INHERITANCE TAX

The Section 529 savings plan remains an asset of the owner until distributed.

Therefore, the plan is considered part of a decedent's estate for Tennessee inheritance tax purposes. Because the Tennessee BEST Plan is exempt, the assets should be deducted before the

calculation of the inheritance tax. **Non-Tennessee** savings plans would be considered part of the taxable estate.

Have questions or comments? Please let us know. [Contact us.](#)

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